Internal Revenue Service

memorandum

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date: NOV 26 1991

to: District Counsel, Salt Lake City CC:SLC
Attention: Mark H. Howard

from: Assistant Chief Counsel (Field Service) CC:FS

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subject: [redacted] Merger: Capitalization of Store Closing Costs

This is in response to your September 19, 1991, request that we reconsider the conclusion reached in the memorandum from the Office of Assistant Chief Counsel (Income Tax & Accounting) to Branch 2 of the former Tax Litigation Division, dated July 16, 1991. A copy of that memorandum had been transmitted to you in response to your earlier inquiry on the subject taxpayer and issue. We have also received a supplemental submission from you concerning the revenue agent's examination and we have sent you factual material supplied to us by the appeals officer with jurisdiction over the case.

You argue that the costs associated with the subject store closings should not be currently deductible as ordinary and necessary expenses under I.R.C. § 162; rather, these costs should be capitalized. Our earlier memorandum concluded that the costs should be currently deductible. Your request was forwarded to the Assistant Chief Counsel (Income Tax & Accounting) for their reconsideration and it has also been reviewed here.

After having reviewed your September 19, 1991 memorandum, we agree with your statement of the law; yet, it is our conclusion that the limited factual material presented is subject to contradictory interpretations. Application of the <u>National Starch</u> principles to the acquisition here may be appropriate and taking the capitalization position is certainly not untenable. Expenses incurred in a merger context that lead to long-term benefits should be capitalized. Your memorandum (at p. 9), however, seems to take the position that expenditures which "would not have been paid but for the change in ownership" must be capitalized. The National Office has not taken the position that any expense subsequent to a merger that would not have been incurred but for the occurrence of that merger must be capitalized.

We do not object to the position that the store closing costs should be capitalized if the facts demonstrate that these were incurred directly in order to facilitate the merger. The developing of facts on the matter is the province of the field

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offices. For example, as was stated in our previous telephone conferences with you, if closing of the stores was required by the Federal Trade Commission in a divestiture order or settlement agreement as a condition of the acquisition, then such cost should be capitalized. If, on the other hand, the store closings have no such immediate direct nexus to the merger but simply occurred as a result of economies of scale, poor location, or inherent duplication existing after the merger has taken place, then these costs are properly current deductions.

In sum, in the limited factual context presented to us, we are unable to state definitively that the store closing costs here must be capitalized. As stated in our earlier memorandum (at p. 2), given that the costs of divestiture, whether voluntary or involuntary, are generally currently deductible, the capitalization position may be difficult to support -- even taking the taxpayer's burden of proof into account. We are not, however, categorically rejecting the possibility that an adequate factual basis might exist which supports this position. The Office of Assistant Chief Counsel (Income Tax & Accounting), after reviewing your request for reconsideration, states that its prior memorandum was intended as general guidance only, field analysis of the pertinent facts may lead to a different conclusion.

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DANIEL J. WILES

By: Gerald M. Horan

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